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SUBJECT: CENTRAL BANK SLASHES RATES FURTHER, HINTS AT  
WANING EXPANSIONARY POLICIES

¶1. (U) On May 29th the board of Colombia's central bank announced it would cut key interest rates 100 basis points to 5 percent in the wake of reports of falling consumer demand and industrial production. The drop is the sixth cut in rates since December of last year (500 basis points total) and leaves the key rate at its lowest since 1998. The board also announced that this change would be the final 100 basis point cut, with any future cuts being between 25 and 75 basis points, thus marking a slowing of its expansionary policies as the Colombian and U.S. economies cautiously recover.

Less concern about inflation, more about demand and production

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¶2. (U) While the main concern for the Colombian economy a year ago was rising inflation, the bank's focus has shifted to a slowing economy. March's inflation rate of 5.73% (down from 7.67% in 2008), coupled with grim macroeconomic data from the fourth quarter of 2008 and the first quarter of 2009 sparked the loosening trend that began in December of 2008. Colombia's economy contracted 0.7 percent in the fourth quarter of 2009, and in the first quarter of this year, industrial production fell by 7.5 percent and retail sales by 5.2 percent. After maintaining a tight monetary policy last year, the slump in Colombia's economy and the expansion in monetary policy over the last sixth months have allowed the central bank to both temper inflation and stimulate growth. Carlos Rojas of the National Association of Financial Institutions (ANIF) told us ANIF believes the rate cut to be an appropriate reaction to the current downturn. Highlighting ANIF's stance that the central bank must play a key role in countering effects of the business cycle, he said the size of the cut (slightly larger than what ANIF had anticipated) indicated the board was "on top of (its) game".

End of slashes, maybe just tweaks

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¶3. (U) The central bank also announced that this cut would be the last such cut, as they anticipate inflation falling to the target rate of 5.5 percent over the coming months, and Colombia's economy recovering in the second half of 2009. The bank noted that future cuts would likely only amount to 25 to 75 basis points. Central bank chairman Jose Dario Uribe noted in the press that commercial loans had responded to the previous 5 cuts totaling 400 basis points. The central bank's read is that this final cut will sufficiently reduce the price of corporate lending to jump-start production in time for recovery. While the board is keeping its options open to future, smaller rate reductions, it appears they believe the need for these 100 basis point cuts is coming to an end.

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